UNITED NATIONS

WORLD INVESTMENT REPORT

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TRANSNATIONAL CORPORATIONS NOW A MAJOR FORCE IN INTERNATIONAL ECONOMIC TRANSACTIONS, UNITED NATIONS STUDY FINDS

Transnational corporations and the foreign direct investment they engage in are rapidly becoming major actors on the international economic scene, according to the *World Investment Report 1992: Transnational Corporations as Engines of Growth*, a United Nations report issued this month.

The report, published by the Transnational Corporations and Management Division of the United Nations Department of Economic and Social Development, finds that transnational corporations (TNCs) have come to account for a substantial part of the assets, employment and trade in selected industries of many host countries, though foreign direct investment (FDI) as a proportion of gross domestic capital formation is under 10 per cent in most cases. The number of such companies—which has never before been estimated—exceeded 35,000 by 1990, with about 150,000 foreign affiliates. The world stock of FDI now stands at $1.7 trillion, with flows in 1990 amounting to $225 billion.

Sales by foreign affiliates are important means of delivering goods and services to markets world-wide: By the late 1980s, global sales of TNC goods and services had reached about $4.4 trillion. Moreover, the world is "increasingly characterized by a symbiotic relationship between trade and foreign direct investment", the *Report* says, with intra-affiliate trade accounting for about one third of total trade.

For many developing countries, FDI—virtually all of which is generated by TNCs—has become the principal source of foreign capital, representing 74 per cent of total long-term capital inflows from private sources of over 90 developing countries between 1986 and 1990, the *Report* states. FDI also represents an increasing share of total investment in most countries, and in fact has grown by an average of 25 per cent a year. In short, FDI has become an important "means by which a growing number of countries are integrated in the international economy", with more and more countries opening their economies to foreign direct investment, competition for investment becoming more intense, and new policy agendas emerging.

Among the other trends highlighted by the *Report*:

- TNCs outspend major Governments in the research and development of technologies; the combined R&D expenditures of the 10 largest United States TNCs exceed those of the French and British Governments, for example.
- TNCs are increasing their involvement in some developing countries, particularly in Asia and Latin America, but those nations' share in world flows is declining, and the distribution among them is highly uneven.
- The growth of FDI is increasingly concentrated in the so-called "Triad" of the United States, the European Community (EC) and Japan, which together account for some three fourths of all FDI flows.

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- FDI "clusters" are emerging, in which foreign direct investment in developing and Central and Eastern European countries is dominated by a single Triad member. Affiliates of United States TNCs located in Mexico, for instance, account for nearly one third of that country's total trade with the United States.
- Central and Eastern Europe, as well as countries belonging to the former USSR, is likely to become more important as a host region for FDI, and the *Report* predicts that cumulative investment flows to the region could exceed $50 billion by the end of the decade.

"TRIAD" REFLECTS REGIONALIZATION OF INVESTMENT ACTIVITY

Developed countries continued to attract more than four fifths of world-wide FDI inflows in 1990, reports the United Nations study. Members of the "Triad", accounting for approximately 70 per cent of world inflows and 83 per cent of outflows, have also been investing largely within the Triad itself and increasingly in their own regions. "With greater integration of non-EC Western European countries, the European Economic Area (EEA), comprising countries belonging to the EC and the European Free Trade Association (EFTA), is emerging as a powerful economic region," the *Report* notes, suggesting that the Triad would be more aptly described as including Japan, North America (Canada and the United States), and the EEA.

Each pole of the Triad is also strengthening its ties to selected developing countries which are usually but not necessarily in its own region. The United States is the dominant investor in most Latin American countries and in a few Asian countries. Japan has added Singapore and Taiwan Province of China to its Asian "cluster". Members of the EC continue to be the dominant investors in Central and Eastern Europe, Africa and a few Asian countries where they have strong historical ties.

A converse trend is also in evidence: each Triad member is investing in host countries clustered around other Triad members. The *Report* says this is a means by which corporations seek to ensure access to markets despite the creation of regional trade and investment blocs. It cites the case of the Nordic countries, where "the surge of inward investment after 1984 reflects the determination of Governments to pursue policies more favourable to TNCs prior to the onset of wider European economic integration". The increased regional integration of North America with Latin America and of Eastern and Western Europe will only further that trend.

In a related development, the *Report* is predicting that the strategies of TNCs to build regionally integrated, independently sustainable networks of overseas affiliates around each of the three poles of the Triad are likely to be an important factor in the growth of intra-regional trade. Intra-regional trade for the EC now accounts for 61 per cent of its total trade in goods. For Asia, the figure is 41 per cent, and for North America, 35 per cent.

MIXED INVESTMENT PICTURE FOR DEVELOPING COUNTRIES

Developing countries have benefited from the growth in overall FDI flows, receiving $32 billion in 1990, or about as much as the whole world did a decade earlier (in current prices). Their current share of total inflows (17 per cent), however, is less than it was 10 years ago. Moreover, during the period 1986-1990, the 10 largest host economies (Argentina, Brazil, China, Egypt, Hong Kong, Malaysia, Mexico, Singapore, Thailand and Taiwan Province of China) accounted for nearly 70 per cent of flows to the developing world as a whole.

While most developing countries "currently do not receive as much as they need to help stimulate development", according to the *Report*, because of the technology-skills package that accompanies investment capital, what they do receive from TNCs is highly important, and TNCs are likely to become even more crucial to the growth of developing countries. The *Report* mentions five major structural changes in the world economy which have contributed to this:

- The increasing importance of market forces, particularly trade and FDI liberalization, in many developing and Central and Eastern European countries.
- Technology and the "shrinking of economic space": for service industries in particular, access to powerful computer-communication networks, owned by single firms or a group of firms, is increasingly becoming the basis of international transactions.

- The globalization of certain key industries, such as automobiles and electronics.
- The rise of the services sector.
- The regionalization of the world economy.

Africa received only 7 per cent—$2.2 billion, roughly equal to that of a small country like Portugal—of all investment flows to developing countries in 1990. The figure was a 50 per cent drop from the exceptionally high levels of 1989, with most of the decline attributable to reduced flows to Nigeria and Egypt (in the case of the latter, primarily because of the Gulf conflict). Non-oil-exporting African countries, most of them least developed, received on average less than $0.5 billion annually during the second half of the 1980s—about what Papua New Guinea alone attracted during the same period.

Asia, which outstripped Latin America in 1986 in terms of inflow of investment capital, continued in 1990 to attract the lion's share of developing country FDI—about 61 per cent. The Asian region also continued to be an exporter of capital, with an outflow of just under $8 billion. On average, outflows from Asia grew by 47 per cent yearly during the 1980s (75 per cent during 1986-1990). For the Republic of Korea and Taiwan Province of China, outflows exceeded inflows, a pattern usually characteristic of developed countries. The main impetus for external investment seems to have been appreciation of their currencies and removal of restrictions on outward capital flows, combined with the threat of protectionism from their major developed country trading partners and their loss of status as developing countries entitled to preferential treatment in trade. China too has emerged as a significant investor abroad, with outflows reaching $830 million in 1990, as its enterprises sought to penetrate new markets and acquire technology and management skills.

LATIN AMERICA AND CARIBBEAN REBOUNDS

There was a resurgence of economic growth in a number of countries in **Latin America and the Caribbean**, which received 32 per cent of all investment inflows to developing countries. In addition, the proposed North American Free Trade Agreement (NAFTA), and the Enterprise for the Americas Initiative—under which the United States has signed bilateral trade and investment framework agreements with many Latin American States—could have a significant effect on investments in the region. The impact has already been felt in Mexico, where, as of July 1991, affiliates of United States companies planned to increase capital spending by 20 per cent in 1991, as compared to a planned 9 per cent increase for the region as a whole. The *Report* also foresees investments in Mexico by TNCs from outside the region as they move to take advantage of duty-free access to the United States market.

"A NAFTA will create new investment opportunities in Mexico that will allow North America-based TNCs to further gear their production in Mexico towards serving the North American market", the *Report* predicts. The Agreement could also raise the locational advantages of Mexico as a host country and result in a shift of some investment in Asia aimed at sourcing of labour-intensive products and components to North America.

While the Agreement could provide non-United States TNCs with an important incentive to build an export capacity in Mexico, however, high local-content requirements could discourage foreign investors in some industries —such as car manufacturers—from establishing themselves in North America. Such requirements might none the less benefit Mexico if they served to attract additional FDI, and in fact moves towards NAFTA appear to have already increased the locational advantages of Mexico, with German and Japanese TNCs, among others, pledging large investment projects. At the same time, investment in the United States by Mexican firms has already begun to increase and is likely to continue to do so if NAFTA opens up the Mexican market to increasing competition.

In contrast to Asia, Latin American TNCs have not emerged as strong investors abroad, which the *Report* attributes to past inward-looking trade and industrialization strategies; but this may change with recent policy developments in Latin American countries.

The "least developed" countries, a United Nations grouping of 47 of the world's poorest nations, attracted less than 1 per cent of developing country FDI in 1990. As the *Report* points out, the growth impact of TNCs "may

be greater for middle- and high-income developing countries than for low-income countries". This is not only because the latter receive very little FDI, but also because the key requirements for growth in those countries —raising agricultural productivity, improving basic infrastructures and increasing the educational and nutritional standards — tend to be marginal to the activities of TNCs.

GOOD PROSPECTS FOR CENTRAL AND EASTERN EUROPE

By January 1992, the number of joint ventures and affiliates registered in Central and Eastern Europe and countries belonging to the former USSR had reached 34,000, more than doubling since the beginning of 1991, according to the *Report*. Foreign equity participation committed to these enterprises totalled over $9 billion, but actual investments were small. While most companies that invest in the region are attracted by the size of the domestic market, some of them, especially in the automobile and electronics industries, utilize the region as a production base for Western European markets. Japanese, United States and European manufacturers have set up plants in Eastern Europe to supply both domestic and foreign markets. The proximity to Western Europe and the availability of low-cost skilled labour is bound to prove attractive to TNCs. Other positive factors are the region's significant liberalization of FDI regimes and the intensified privatization of state-owned enterprises. World-wide, the number of privatizations more than quintupled between 1985 and 1990.

RECENT POLICY DEVELOPMENTS TARGET TNCS

In reviewing some of the important recent policy developments affecting TNCs, the *Report* provides an analysis of how the draft agreements being considered at the Uruguay Round of multilateral trade negotiations will affect foreign direct investment. It finds, for example, that the draft agreement on trade-related investment measures (TRIMs), if adopted, is unlikely to have any significant impact on FDI flows, in part because most developing countries have already substantially liberalized their FDI regimes.

The draft text on trade-related aspects of intellectual property rights (TRIPs), on the other hand, should have a favourable impact on FDI. The agreement is aimed at setting minimum standards for the protection of seven categories of such rights—copyright, trademarks, geographical indications, industrial designs, patents, layout designs of integrated circuits, and trade secrets. Since the standards will generally be higher than those now prevailing, the *Report* is predicting that they will induce more R&D by TNCs and provide them with an incentive to innovate in product areas of special interest to developing countries.

Of 82 policy changes relating to foreign investment made by 35 countries last year, 80 were intended to ease the process. In some 70 countries, privatization programmes are now offering new opportunities for FDI. In addition, Governments have been moving in the Uruguay Round to create the first-ever agreement on international transactions in services, which account for about half of all capital flows.

Also at the policy level, Governments have recognized the importance of foreign investments by negotiating more international laws and by liberalizing national regimes. Bilaterally, the number of treaties to promote and protect foreign investment has shot up, with 64 being signed in the first 18 months of the 1990s, as opposed to only 199 during the entire preceding decade.

In calling for a new perspective for viewing FDI, the *Report* suggests an examination of the influence of trade policies on investment flows, saying that investment-related trade measures (IRTMs) may be as important as TRIMs for the international allocation of resources. More attention should also be given to strategic FDI policies.

In addition, there may be a need for an international public policy framework to keep pace with the rapid globalization of firms and industries. There may also be a need for increasing international transparency of national FDI policies. An international framework could also seek to safeguard global competition and deal with restrictive business practices, either through a web of bilateral arrangements or multilateral negotiations in the framework of the GATT, says the *Report*.

TNCS VIEWED AS ENGINES OF GROWTH

A major focus of the *Report* is on the role of transnationals in promoting growth in developing countries, noting that TNCs provide investment capital, transfer hard and soft technology, develop human resources, expand trade opportunities and support long-term growth. Specifically, they make a significant positive contribution to physical capital; stimulate technology development by local R&D institutions; train unskilled and semi-skilled workers as well as host country management staff; and contribute to improved export performance. However, the prevailing conditions in the host country—and especially the policy environment, level of human resources development and the capacity of domestic enterprises to benefit from the presence of TNCs—are ultimately crucial in determining what effect transnational corporations have on the economy.

"It is above all this integrating, organizing and managerial capacity of TNCs that makes them engines of economic growth within an enabling policy framework and conducive structural conditions in the host economy", the *Report* says. It does, however, express some caution about the role of TNCs, suggesting that "it is probably necessary for a threshold level of domestic economic development to exist in order to benefit most from the potential for greater growth that TNCs can create", particularly for manufacturing and services TNCs.

Another warning relates to the possibly adverse environmental impact of TNC activities, although according to the *Report*, evidence suggests that these are not being shifted disproportionately to developing countries. And while TNCs are the "primary producers and intermediate consumers of chlorofluorocarbons", there is no clear trend as to the share of pollution-intensive industries in total FDI in either developed or developing countries. Large transnationals, too, given their visibility, resources and access to clean technology, may have better environmental records than local firms in host countries. "Regardless of the regulatory framework", comments the *Report*, "transnational corporations undertake environmental protection in their self-interest" and deliver a "package of assets" to host economies.

Other problems would arise if TNC investments remained concentrated in enclaves within the host economy, with few linkages to local business. That could lead to dualistic economic structures and make sustainable growth more difficult for the country. If TNCs resorted to "transfer pricing" (fiddling the books to move money out of the country), the *Report* says that the benefits for the host country could be reduced. Similarly, if transnationals abused their market power to reduce competition, long-term growth prospects would be harmed by stifling local entrepreneurs.

Among the other positive and negative impacts of TNCs on developing countries discussed by the *Report* is the fact that "the failure of a TNC may adversely affect a large number of persons in many countries", as demonstrated by the recent demise of the Bank of Credit and Commerce International and the Maxwell Communications Corporation. Likewise, the increasing tendency of TNCs to "internalize technologies among themselves through strategic alliances" makes it hard to access technology without FDI.

Accordingly, the *Report* advises that developing countries should be sensitive to the potential contributions of TNCs in formulating their policies.

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